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FM AMEMBASSY JAKARTA
TO RUEHC/SECSTATE WASHDC 1264
RUEATRS/DEPT OF TREASURY WASHINGTON DC
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RHMFIUU/DEPT OF ENERGY WASHINGTON DC
INFO RUEHZS/ASSOCIATION OF SOUTHEAST ASIAN NATIONS
RUEHKO/AMEMBASSY TOKYO 0050
RUEHBJ/AMEMBASSY BEIJING 3676
RUEHBY/AMEMBASSY CANBERRA 0012
RUEHUL/AMEMBASSY SEOUL 3773
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UNCLAS SECTION 01 OF 07 JAKARTA 012555

SIPDIS

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DEPT FOR EAP/MTS, EB/ESC/IEC, EB/TPP/BTA/ANA
TREASURY FOR IA-
DOE FOR CUTLER/PI-32 AND NAKANO/PI-42
USDOC FOR GOLIKE/4430

E.O. 12598: N/A

TAGS: [ECON](#) [EINV](#) [ENRG](#) [ETRD](#) [EFIN](#) [PGOV](#) [ID](#)

SUBJECT: US-ASEAN BUSINESS COUNCIL DELEGATION VISITS JAKARTA

¶1. (SBU) Summary. President Susilo Bambang Yudhoyono (SBY) told a visiting U.S. ASEAN Business Council (USABC) delegation on October 12 that he remains optimistic about Indonesia's economic outlook and committed to economic reforms and the process of democratization. Vice President Jusuf Kalla told the group in a separate meeting that the GOI places a high priority on macroeconomic stability and security to encourage investment. Coordinating Minister for Economic Affairs Boediono said the Government's resolve to improve the investment climate "remains intact and has even grown stronger" and that "tangible progress" is likely by the end of 2006 in several areas including the passage of new customs and investment laws. Minister of Trade Mari Pangestu said the Government of Indonesia (GOI) is focused on improving its customs procedures and is working with Singapore on a Free Trade Zone pilot project in Batam. Investment Coordinating Board (BKPM) Chairman Mohamed Lutfi claimed poor regulation of the non-bank financial sector is holding back Indonesia's economic development. Minister of Energy and Mineral Resources Purnomo Yusgiantoro described the GOI's biofuel development initiative, and said the GOI seeks to develop operational nuclear power plants by 2015. Coordinating Minister for Political, Legal and Security Affairs Widodo A.S. said the GOI continues to undertake judicial reforms and pursue its anti-corruption campaign in an effort to provide greater legal certainty and contract sanctity. Minister of State Owned Enterprises Sugiharto said the GOI wants to consolidate and streamline the current 139 State-Owned Enterprises (SOE) to 85 by 2009, but acknowledged this task would be politically difficult. Paragraph 21 reprises the key issues Mission members raised during their various meetings with the GOI. End Summary.

¶2. (U) A 41-member USABC delegation visited Jakarta October 9-12 to hold meetings with SBY, Vice President Kalla, and a number of GOI Ministers and senior officials. In addition to the ministers cited above, the delegation also met Finance Minister Sri Mulyani Indrawati, State Minister of Research and Technology Dr. Kusmayanto Kadiman, and State Minister for National Development Planning Paskah Suzetta. At the conclusion of the mission, BKPM Chairman Mohamed Lutfi and USABC President Matthew Daley signed a Memorandum of Understanding to promote greater U.S. investment in Indonesia and closer links between the U.S. and Indonesian business sectors. A list of companies with representatives

who participated in the mission is in paragraph 22.

President Susilo Bambang Yudhoyono

13. (SBU) SBY began the October 12 meeting by noting that many companies represented in the delegation had long histories in Indonesia and that, in general, U.S. investors had not abandoned Indonesia during the worst moments of the Asian Financial Crisis. SBY stressed that he remains optimistic and committed to economic reform and Indonesia's democratization. In spite of all the challenges Indonesia and his government have faced -- such as the tsunami, earthquakes, terrorist attacks, avian influenza, haze, oil price increases, and high interest rates -- Indonesia's macroeconomic indicators continue to improve: exports grew by 17% in 2005, GDP growth is expected to top 6% in 2007, the debt-to-GDP ratio could drop to 40% in 2007, and interest rates and inflation continue to decline. Further, Indonesia advanced in September 2006 from 69 to 50 on the World Economic Forum's Global Competitiveness Index rankings for 2006-7 and the Jakarta Stock Exchange is one of the top three performers in Asia.

14. (SBU) SBY noted that to encourage greater investment, the GOI is undertaking major reforms, focusing on infrastructure development, combating corruption, and creating a special economic zone on Batam, Bintan and Kariman Islands. He said the Government's anti-corruption drive has investigated 90 mid-to-high-level officials, including seven governors, 50 regents and vice regents, 10 mayors, and 13 members of the National Parliament. As a consequence, a "fear factor" is deterring corrupt practices among many GOI officials. He

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added that democracy, good governance, transparency and accountability are inextricably linked to economic growth, job creation and poverty alleviation.

15. (SBU) On energy policy, SBY noted that Indonesia hopes to add 10,000 megawatts of power generation in the next few years. He opined that the days of oil prices below \$40 per barrel are likely over, and that as a result, it is important for Indonesia to explore alternative energy sources such as biofuels. He felt Indonesia would be particularly competitive in this area given its wealth of arable land.

Vice President Kalla

16. (U) In his October 10 meeting with the group, Vice President Jusuf Kalla noted that the GOI places a high priority on macroeconomic stability and security to encourage investment. He said he hopes that foreign direct investment (FDI) will bring a multiplier effect to Indonesia and create more jobs. "We need a lot of growth and investment to help our 240 million people," he stated. Indonesia needs more value-added industry in manufacturing, energy and technology. USABC President Matt Daley said that some U.S. companies have been taking a fresh look at Indonesia, along with those which already have a long-term relationship.

Coordinating Minister for the Economy Boediono

17. (U) Boediono admitted in his October 9 meeting with the group that the GOI's progress in improving the investment climate has been mixed since SBY signed Presidential Instruction 3/2006 in February 2006. Nonetheless, Boediono said the Government's resolve to improve the investment climate "remains intact and has even grown stronger" over the last few months. Boediono said he expects "tangible progress" by the end of 2006 in several areas including the passage of a new Customs and Excise Law and a new Investment

Law. However, the passage of the three tax amendments now before Parliament is much less sure, and Boediono said he could not even offer "90% assurance" that the three would pass. Of the three amendments, the draft amendment to the Law on Tax Administration is the most important because it would establish a new relationship between tax officials and taxpayers, including the business community. Boediono said he hoped at least one of the three tax bills would pass in 2006 and be operational in 2007.

¶8. (U) Improving Indonesia's labor regime is the most difficult investment climate issue the GOI faces, Boediono acknowledged. The issue is politically sensitive, and after consultations with stakeholders, the GOI has decided not to seek changes to Indonesia's labor law "this year or even next year." Rather, the GOI will look into the possibility of improving the labor climate through changes in regulations. "There are a number of areas where we could adjust regulations," Boediono said. The GOI is also committed to cutting processing times for investors at the national and local level. A number of regency or city governments in Central Java, Kalimantan, Bali, and other areas have established "one-roof" or integrated service centers for investors, and the Government's Special Economic Zone (SEZ) strategy is also aimed at simplifying approvals in designated areas. Batam serves as the pilot project for the GOI's SEZ strategy, and Singapore is helping Indonesia in three areas: improving the regulatory climate through feedback from investors and identifying on-the-ground problems; raising Indonesia's capacity to manage SEZs; and raising the level of vocational training.

¶9. (SBU) Boediono also offered some details on the GOI's efforts to reform the bureaucracy. He told the group SBY has appointed a small team or "Presidential Delivery Unit" to be attached to the Office of the Presidency. The team will help the President monitor and accelerate reforms in a

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number of important policy areas, including the investment climate, bureaucratic reform, state-owned enterprises, and legal reform. The team is "good for Ministers like us", Boediono noted because it will increase the GOI's capacity to develop and implement reform measures. Boediono concluded by thanking the delegates for the support of U.S. business in Indonesia. "Democracy requires patience," he noted, and "quick, decisive, radical change is not possible. We can't push laws through like we could 10 or 20 years ago," but rather need to go through lengthy consultations with Parliament. But the Government is persistent, patient, and committed to reform.

Trade Minister Mari Pangestu

¶10. (SBU) Minister of Trade Mari Pangestu told the USABC delegation on October 9 that she was hopeful that Indonesia would be removed from the IPR Special 301 Priority Watch List during the current Out of Cycle Review. The newly formed ministerial-level National IPR Task Force is developing a national plan of action. The greatest challenges will be sustaining enforcement and creating greater public awareness about the importance of IPR. Pangestu welcomed the USABC's decision to conduct a study of non-tariff barriers in Indonesia and noted that Indonesian businesses and exporters, particularly in the agricultural sector, need capacity building and support to better understand and meet U.S. import standards. She added that Indonesia was currently Chair of the ASEAN Auto Sector Committee and that the GOI should prioritize the sector since it was one of the few vertically integrated sectors in Indonesia.

¶11. (SBU) Pangestu noted that the GOI continues to have Economic Partnership Agreement talks with Japan in which the two countries are addressing many issues similar to those

that arise in the GOI's trade discussions with the U.S. Although Pangestu said she did not expect Indonesia and the U.S. to pursue a free trade agreement anytime soon, regular Trade and Investment Framework Agreement (TIFA) talks are gradually addressing issues that could be roadblocks to a future FTA. She noted Indonesia is actively pursuing a bilateral trade agreement with Australia and that both countries are currently working on a joint study of the costs and benefits of free trade.

BKPM Chairman Mohammad Lutfi

¶12. (SBU) During their October 10 meeting, Investment Coordinating Board (BKPM) Chairman Mohamed Lutfi informed the delegation that U.S. investments in Indonesia amounted to \$7 billion between January 1990 and June 2006 and included 342 projects. In the first half of 2006, however, U.S. investors started only 22 new projects worth \$28 million, compared to 27 projects worth \$58 million for the same period in 2005. Lutfi noted that U.S. investors have traditionally found the mining sector attractive, but that interest in that sector has diminished significantly due to regulatory and legal uncertainties.

¶13. (SBU) Lutfi said he remains very optimistic about Indonesia's ability, for three reasons:

--the Government's emphasis on infrastructure development, including plans to add 13,000 megawatts of power generation with investments of \$6 billion;

--the country's large population of 220 million, with some 18 million members of a rapidly expanding middle class; and

--remarkable natural resources.

¶14. (SBU) Lutfi admitted that Indonesia needs to learn to rely less on exporting raw resources while making a gradual transition to a knowledge-based economy. In the short term, though, it should take great advantage of its wealth of

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natural resources and unusually high commodity prices. Lutfi claimed that Indonesia's weak economy is largely due to poor financial market regulation in the aftermath of the Asian Financial Crisis. He specifically decried GOI decisions to leave the regulation of non-bank financial institutions to the Ministry of Finance. Lutfi noted that Indonesia's loan-to-deposit ratio was only 53% in 2005, compared to 136% for Malaysia, 102% for Singapore, and 109% for Hong Kong. He lamented that out of Indonesia's 18 million strong middle class, only 300,000 invest in the country's stock markets. With proper regulatory supervision, Lutfi felt Indonesian markets could triple their current capitalization.

Energy Minister Purnomo Yusgiantoro

¶15. (SBU) Minister of Energy and Mineral Resources Purnomo said the Government hopes Parliament will finish new laws on energy, mining and mineral resources in the next two years. "We have 86.9 billion barrels equivalent of oil and gas resources we wish to convert to reserves," he noted. Most of Indonesia's coal reserves are in Kalimantan where there is little infrastructure, but Chinese investment is helping build railways to transport coal. The GOI also seeks to develop operational nuclear power plants for electricity production by 2015, and seeks cooperation on nuclear energy with France, Japan, South Korea and the U.S. Purnomo noted that only 55% of Indonesia is electrified, leaving millions without power. The GOI plans to take on the challenge of rural electrification with a small, \$400 million budget, leaving larger, more attractive projects for public-private partnerships.

¶16. (U) Purnomo said the GOI hopes to send a team to the U.S. to discuss energy issues with private industry as well as the U.S. Department of Energy, and the USABC offered to help set up meetings. With regard to the electricity law, Purnomo noted that the GOI seeks to avoid the errors of places such as California, learning from others to create a suitable set of energy policies for all sectors. On biofuels, the GOI would like to develop biodiesel and ethanol from palm oil, cassava, and sugar cane. Indonesia already has 180 gas stations which can distribute biofuels, but not enough stock to meet the demand. Purnomo said the GOI wants this program on the fast track to start in 2007.

Coordinating Minister Widodo

¶17. (SBU) Coordinating Minister for Political, Legal and Security Affairs Widodo told the delegation on October 12 that political, legal and security stability have a direct influence on investment and economic development. He noted that the process of democratization in Indonesia is "noisy," but that it is leading to a more responsible, transparent, and accountable government. Widodo said the GOI continues to undertake judicial reforms and pursue its anti-corruption campaign in an effort to provide greater legal certainty and contract sanctity. He also highlighted recent positive developments in Aceh and Papua, and the GOI's "undeterred" efforts to combat terrorism.

State Minister for State-Owned Enterprises Sugiharto

¶18. (U) In his October 9 session with the group, Sugiharto stressed the importance of consolidating and streamlining the current 139 State-Owned Enterprises (SOE) to 85 by 2009. The two factors driving this reform are the public demand for transparency, and the need to raise standards of efficiency and good corporate governance in the SOE sector. Sugiharto noted candidly that his task is more challenging because of the political sensitivities attached to most SOEs. In addition, SOEs have a mandate to perform public service obligations (PSO) in various sectors, such as postal service, and to do so at a profit. He acknowledged that from a purely business standpoint, decisions on reform and

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privatization would be 'very simple', because the top 10% of SOEs produce 90% of overall profits, while the bottom 10% are responsible for 90% of all losses. He commented that the Government's decision to repay Indonesia's IMF debt early demonstrates its commitment to enhancing the country's credit rating. Sugiharto also noted that state electricity company PLN's recent \$1 billion dollar bond sale played a key role in raising funds to boost infrastructure and power generation capacity.

¶19. (U) Sugiharto also commented on financially beleaguered national airline Garuda Indonesia. He said the GOI would "politically salvage" Garuda in 2006 with injections of up to Rp 500 billion (US \$55 million). As a market policy, the GOI "could privatize Garuda." However, the preferred, politically acceptable alternative would be to find a strategic partner to purchase a minority equity share, coupled with a management agreement.

National Planning Ministry (BAPPENAS)

¶20. (U) In a meeting with the State Ministry for National Development Planning (BAPPENAS), Ministry officials noted Indonesia's need to expand its infrastructure capacity, especially for transportation and telecommunications. A top priority is to create a rail link from Jakarta's main commercial airport, Soekarno-Hatta, to the city. The GOI prefers soft loans with interest rates of 3.5% or less from

foreign investors to assist with these projects. BAPPENAS also has a plan to increase Indonesia's information communication technology (ICT) capacity. The plan includes policy and regulatory reform, building capacity in rural areas, and restructuring of the Ministry of Information itself.

Ministry of Health

¶21. (SBU) Director General for Pharmaceutical and Medical Equipment Dr. Richard Pandjaitan described on October 10 the international concern over the possibility of an avian influenza (AI) pandemic. Dr. Santosos Soeroso, Director of Sulianti Saroso Infectious Hospital (an AI referral hospital) then reported on the GOI's national AI control strategies and on the formation of the National Committee on Avian Influenza Management and Pandemic Alert. Soeroso noted that Indonesia's mortality rate from avian influenza is the highest in the world (75%) because most patients do not seek medical attention until they are in advanced stages of pneumonia and respiratory distress. Soeroso reported that the GOI will expand avian influenza referral hospitals from 44 to 100. (Note: Despite Soeroso's claim, MOH has rejected requests from the Mission's NQal Medical Research Unit (NAMRU-2) to expand its AI surveillance referral hospital network.)

Key Issues Raised

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¶22. (SBU) USABC delegation members raised a number of economic policy issues or doing-business problems in the group's meetings:

--Auto Luxury Taxes: A Ford Motor Company representative noted that Indonesia has exceptional potential as an auto producer. However, the country's luxury tax system remains a serious obstacle because it distorts the market. Ford would like to see the elimination of luxury tax distinctions based on body type (sedan vs. non-sedan) and fuel (diesel vs. gas), with overall lower luxury tax rates. The longer term vision would be to move to a system based on the purchase price of cars. VP Kalla noted that the luxury tax system was set up for historical reasons to encourage public transportation and create an incentive for commercial vehicles, but now there is improved engine efficiency and less difference between the price of diesel and gas. Boediono said it is very important to develop Indonesia as

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an auto export base, and said he would ask the Ministry of Finance to look into the issue. He noted that Ford's presentation "seems to make sense," and that some of the distinctions in luxury tax rates have been in place for decades and are "no longer quite relevant."

--Biotech Crops: A Monsanto representative encouraged a change in regulations to facilitate the use of biotech crops to improve farm productivity and overall growth, noting the success of these in India, China, Australia and Philippines. Kalla said he appreciated the help of companies such as Monsanto in increasing yields and reducing poverty.

--Health Care as an Economic Driver: A representative of Johnson and Johnson inquired about the potential for health care as a business driver in Indonesia, noting Singapore and Thailand's success with medical tourism. VP Kalla said there are now more private than public hospitals in Indonesia, though the overall density is still low. There is an insufficient number of doctors and those available are working too hard and too long. This sector needs to grow, Kalla concluded.

--Caps on Media/Entertainment Investment: A Time Warner representative noted that "good content drives growth" in

the information technology sector, and that media and entertainment companies are interested in Indonesia, however, they are restricted by the 20% cap on foreign participation and are not allowed to establish fully owned distributors of video products. An effective, arms-length broadcasting regulator is also important, the representative stated, the representative noted, and encouraged the GOI to establish a level playing field between international and domestic companies. VP Kalla responded that this issue is complex, and requires a longer discussion. Boediono said the issue is sensitive politically, and that the GOI wants to benchmark Indonesia's policies to international developments.

--Sugar Import Tariffs: A Coca Cola representative said his company wants to see the Minister of Finance extend her decree reducing import duties on sugar since the domestic sugar industry does not need tariff protection. VP Kalla said the objective is to create harmony between producer and consumer. Boediono said the Ministries of Agriculture and Industry have staked out opposing positions on the issue that the GOI is trying to resolve.

--Health Care Issues: In response to a question about Indonesia's priority training needs in the health care sector, Dr. Hardiman from the Health Ministry noted that Indonesia only has one cardiac care center located in Jakarta and needs additional centers on Sumatra and Kalimantan. Hardiman noted training in pediatric cardiology is also an urgent priority. Another USABC delegate noted Indonesia has a large number of hospitals and local health clinics, and suggested that the GOI consider developing expertise in the manufacturing of medical devices and medical equipment.

--Express Delivery Services: A UPS representative encouraged Indonesia to "level the playing field" by permitting 100 percent foreign ownership and ending the postal service monopoly on express delivery services. She also raised concerns about a new draft postal law currently circulating inside the GOI and the effects it might have on the flow of goods in and out of Indonesia. In response, Pangestu said that the GOI is making improvements to the country's logistics a priority. As part of this effort, the GOI is cooperating with Singapore in launching an ASEAN green-line program and establishing a customs single window pilot project in Batam. Sugiharto said the postal service has a public service obligation, and must work within the constraints of that mandate. At the same time, the postal service must become profitable while still servicing remote parts of Indonesia.

--Locomotives Upgrade: A General Electric (GE)

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representative noted that rail is a vital transport option in Indonesia, and stated his company's interest in replacing the aging locomotives of Java's train system with newer, more efficient models. About 20-30% of the contact could be produced in Indonesia, creating jobs. VP Kalla said he appreciates GE's production facilities in Java and said the Ministry of Transportation is also studying how to increase rail capacity in Sumatra and Kalimantan as well as in Java. Sugiharto agreed that the Indonesian fleet of locomotives needs immediate upgrade.

--Automobile Fuel Standards: A Ford representative asked that Indonesia move more rapidly toward nationwide mandated sale of high quality diesel and unleaded fuels. Such nationwide availability of cleaner high quality fuels would lead to cleaner air and address the concerns of consumers owning cars with emission controls. The Ford representative also urged standardization of biodiesel and bioethanol so that vehicle suppliers could supply compatible engines. A MEMR official noted that the GOI has already created a standard for biodiesel and is now preparing one for

bioethanol.

--IPP Project in Sumatra: A representative of Virginia-based AES discussed his company's proposal to develop a 1200 megawatt coal-fired power facility in South Sumatra, in consortium with Japanese and Indonesian companies. AES asked for the GOI's support in fast-tracking the project. The largest constraint is the lack of transmission lines to bring power from the generating site to West Java. Boediono noted that Indonesia's need for power is huge, and that the country is already feeling the early signs of shortages. Moving forward with Independent Power Producer (IPP) projects remains the GOI's preferred means for generating more power, but the urgency of the situation requires PLN to fill the gap between 2007 and 2010 with its 10,000 megawatt "crash program." The Government had a bad experience with IPPs in the past, and wants to replicate successful models. Sugiharto agreed the AES project must be completed within three years to meet growing power demands in Java, and that the government was committed to "quick action" to encourage IPPs.

Delegation Members

123. (U) Representatives from the following companies participated in the USABC mission:

- Exxon Mobil
- Freeport McMoRan Copper & Gold, Inc.
- AES Transpower
- Cargill, Inc.
- Chevron
- PT Coca-Cola Indonesia
- Conoco-Phillips
- Ford Motor Company
- General Electric Company
- JHPIEGO (An international health organization affiliated with Johns Hopkins University)
- Johnson and Johnson
- Marathon Oil
- McDermott
- Microsoft Corporation
- Monsanto Company
- Oracle Corporation
- PT HM Sampoerna Tbk
- Star TV (News Corporation)
- Time Warner, Inc.
- United Parcel Service

PASCOE